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Legislative Council
Legislative Council Building
8 Jackson Road
Central
Hong Kong

**Attn: Clerk to Bills Committee on
Securities and Futures Bill and Banking (Amendment) Bill 2000**

Dear Sirs,

Banking (Amendment) Bill 2000 and Securities and Futures Bill

We thank you for your letter of December 11, 2000, reference CBI/BC/4/00, regarding your invitation of our view on the captioned Bills and furnish you with our comments as follows:

Banking (Amendment) Bill 2000

We have noted that one of the purposes of the Banking (Amendment) Bill 2000 is to enable the HKMA to enhance the regulatory functions in relation to authorised institution activities that are exempt under the Securities and Futures Bill. The Banking (Amendment) Bill 2000 aims at levelling the playing field between the exempt dealer and licensed corporation. As an exempt dealer under section 118 of the Securities and Futures Bill, authorised institutions are allowed to carry on one or more than one of the following regulated activity:

- Type 1: Dealing in securities
- Type 2: Dealing in futures contracts
- Type 4: Advising on securities
- Type 5: Advising on futures contracts
- Type 6: Advising on corporate finance
- Type 7: Providing automated trading services
- Type 9: Asset management

We have also noted that the above regulated activities include advising on and/or dealing in futures contracts to which, under the existing Commodities Trading Ordinance, Chapter 250, exempt dealers status is not granted.

We fully support the amendment of the Banking Ordinance to provide for the regulation of authorised institutions in relation to regulated activities. We also support the idea that HKMA will act as the front-line regulator to supervise authorised institutions in the conduct of these activities. Their supervision must parallel and be consistent with the standards applied by the SFC. Specifically, we support the Bill that it:

- empowers the Monetary Authority to publicly or privately reprimand an exempt authorised institution which is guilty of misconduct, and
- requires the Monetary Authority to consent to a person becoming an executive officer of an exempt authorised institution.

Executive Officers

Section 124 of Securities and Futures Bill requires that at least one of the executive officer of licensed corporation must be an executive director of the licensed corporation. It also stipulates that a licensed corporation shall not carry on any regulated activity unless every executive director is approved by the SFC as a responsible officer. This “responsible officer” concept ensures that senior management has the primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the licensed corporation in the conduct of regulated business.

Clause 9 which introduces new Sections 71C and 71D of the Banking Ordinance seems to adopt SFC’s “responsible officer” concept. Section 71D requires that every exempt authorised institution shall appoint not less than 2 executive officers to directly supervise the conduct of the regulated business. Although Section 71C states that such executive officer must have sufficient authority within the institution, it does not define the authority and the rank of the executive officer. We are of the opinion that the executive officer must be senior enough to commensurate with his or her responsibility. Without a director rank or its equivalent, it is doubtful whether the executive officer could satisfactorily assume primary responsibility in the performance of his or her regulatory and statutory duties.

Bank Employees

It is not uncommon that retail investors or prospective walk-in customers come to the branches of authorised institutions to look at share price and seek for investment advice. Investment advice or dealing in financial products are always preformed by front-line bank/branch staff. These front-line bank employees contact with clients directly and include settlement clerks, receptionists, tellers, customer service officers, marketing officers, representatives, branch managers, settlement department managers, etc. In performing their duties, they might have a chance to discuss with clients of which shares are “good buy” or which financial products are suitable. In other words, they give investment recommendation and solicitation of regulated business. According to the Code of Conduct, we, as a registered person, should exercise due diligence when making a recommendation to or solicitation of regulated business from customers and must ensure their suitability for that client. We are also required to assure ourselves that the client understands the nature and risks of the products and has sufficient net worth to be able to assume the risks and bear the potential losses of trading in such products.

Clause 4 amends Section 20 of the Banking Ordinance, which requires the Monetary Authority to keep a register of persons employed by exempt authorised institutions to act for them in respect of their regulated activities. This section is vague. It is not equivalent to licensing of such employees as representatives under section 119 and

120 of the Securities and Futures Bill. In this case, any bank employee, no matter whether or not he or she understands the market or products, could engage in regulated business including securities, futures, corporate finance and asset management. There is a great contrast in legislations between bank employees selling other financial products such as MPF, insurance, real estate agency, etc., and bank employees selling regulated products such as securities and futures contracts. The former is required to be individually licensed and must meet the licensing requirements, whereas the latter is exempt from licensing and does not need to meet any licensing requirements.

In our view, to perform such regulated activity, the bank employees must not only be acquainted with the SFC rules and relevant legislations, but also be required to acquire a working knowledge on a huge number of rules and regulations of the Exchange, for example:

- Cash Market
 - Listing Rules (Main Board)
 - Listing Rules (GEM)
 - Rules of the Exchange
 - Disciplinary Procedures
- Derivatives Market
 - Options Trading Rules of the Stock Exchange
 - Operational Trading Procedures for Options Trading Exchange Participants of the Stock Exchange
 - Rules, Regulations and Procedures of the Futures Exchange
- Clearing and Settlement
 - CCASS Operational Procedures
 - General Rules of CCASS
 - Options Clearing Rules of SEOCH
 - Operational Clearing Procedures for Options Trading Exchange Participants of SEOCH
 - Clearing Rules and Procedures of HKCC

Many of the above rules are complex and difficult even for people possessing relevant industry qualification and working experience. We, therefore, fail to appreciate how a bank employee, without passing a recognised industry qualification and the acquisition of certain years of minimum relevant working experience, could be competent and fit to perform his or her duty of dealing and/or advising customers in those products and comply with the statutory and regulatory rules.

Branches

There is no capital requirement for exempt dealers to restrict their opening of branches. As a matter of fact, any bank premises can offer regulated products or services to clients or potential clients. They can freely establish any outlet such as kiosk, investment centre and so on without any prerequisite requirement. This poses a question of fairness. For licensed corporations, there is limitation to open branches, i.e. 2 branches only. Otherwise, they would have to increase their capital to meet the

Financial Resources Rules. It is also a regulatory requirement that each branch of licensed corporation must appoint a branch manager with sufficient working experience and qualification to be in charge of the branch. But, for banks, there is neither any limitation on the number of branches to be opened, nor any statutory requirement to have an executive officer at each branch to oversee daily regulated activities as well as to supervise employee's misconduct, compliance, settlement and risk management.

Conclusion

The proposed Section 71D and 71C of the Banking Ordinance for the appointment of two executive officers and their consent by HKMA are only minimal requirements to ensure that the authorised institution is competent to handle the regulated activities. We therefore fully support this Bill and also suggest that the executive officers must be of a director rank or its equivalent.

Without extending the statutory provisions of the Banking (Amendment) Bill 2000 to cover the branches of authorised institutions as well as licensing all bank employees performing regulated activities, we are of the opinion that the Banking (Amendment) Bill 2000 could not adequately achieve the guiding principles in the developing of the new regulatory framework, i.e.

- To provide adequate protection to investors
- To minimise regulatory overlap
- To level the playing field between exempt Authorised Institutions and SFC licensees

Securities and Futures Bill

Market Misconduct and Manipulation

Section 163 and 164 of the Securities and Futures Bill authorise SFC to make rules and establish code of conduct guidelines for exempt dealers and licensed persons to comply with in the provision of regulated activity to clients. These codes of conduct or rules will therefore be used by the SFC in considering whether a licensed person is or has been guilty of misconduct or is a fit and proper person to remain licensed. Under such circumstances, licensed persons must perform their duties in compliance with the rules and behave professionally.

However, we have noted that certain class of persons who also give investment advice to public or investors are not subject to the rules, e.g. journalist or authors of financial articles in newspapers, DJ or emcee in radio or television, etc. Certain newspapers or TV programmes are very popular. Their commentary or documentary attracts a large number of audience and creates a great demand or supply force. We also feel that they demonstrate their attitude very much alike in recommending investment and tipping off about horse racing, thus creating a gambling ambience. If this loophole is exploited, the regulatory objective of assisting Government in maintaining financial stability of Hong Kong might not be achievable.

It is concluded that the Bill has not covered all persons who engage in advising and recommending regulated activities, including, but not limited to, those journalists and emcees. It would be helpful if the Bill could consider newspaper articles, radio or TV programmes, etc. as advertisements, invitations or documents as governed by Section 102 so that such articles or programmes could be scrutinized under Section 109. Or, in the alternative, the Bill should specifically stipulate that if such kinds of persons give investment advice and recommendation amounting to market misconduct or manipulation, they will be convicted of criminal offence, and be liable to pay compensation to the investors who follow their advice and suffer losses. It is also recommended to amend the definition of stock market manipulation under section 291, and the defences giving to broadcaster under section 290 of the Securities and Futures Bill to distinguish among a pure reproduction of information, a commentary and an investment recommendation. In any event, those persons who give investment advice or recommendation must be licensed so that they will abide by the code of conduct and the rules.

Issue of Advertisements, Invitations and Documents

Section 102 of the Securities and Futures Bill grants exemptions to licensed or exempt dealers in the issue of advertisements, invitations or documents relating to the offers of investments. Without the acquisition of Exchange Trading Rights, advertisements could be issued freely by exempt dealers and are not required to be approved by the Exchange and/or subject to the Rules of Exchanges, such as section 523 – 526 of the Rules, Regulations and Procedures of Hong Kong Futures Exchange and the Twelfth Schedule of the Rules of the Hong Kong Stock Exchange, which are reproduced as follows:

- **Rules of Futures Exchange**

- “523. *No invitation or advertisement in relation to trading in Futures Contracts and/or Options Contracts shall be published, circulated, distributed or otherwise promulgated by any means whatsoever by any Exchange Participant unless a copy of such invitation or advertisement has, at least fourteen days before the publication or distribution, been sent to and approved in writing by the Exchange. Each such approved advertisement shall be lodged with the Commission as soon as possible after approval and must comply with the Ordinances or any other regulatory requirements from time to time prevailing.*
- 524. *Approval may be given on such terms as the Exchange thinks fit, including on terms requiring amendments or variations to the form or substance of the invitation or advertisement (whether or not such invitation or advertisement has already been made, distributed or published).*
- 525. *Without prejudice to the generality of Rule 524, the Exchange may disallow any invitation or advertisement by any Exchange Participant which in its reasonable opinion has the effect of undesirable solicitation of F.O. Business.*
- 526. *Where any invitation or advertisement by an Exchange Participant is disallowed, the Exchange Participant shall immediately cease any further publication or distribution of it and shall make all reasonable efforts to recover any publication already distributed and withhold the same from further circulation or distribution.”*

- **Rules of Stock Exchange: Twelfth Schedule : Advertising Regulations**

“These Regulations set out the requirements which an Exchange Participant or Dealing Partnership shall comply with when publishing, circulating or distributing invitation or advertisement. An Exchange Participant or Dealing Partnership who fails to comply with these Regulations shall be liable to disciplinary action by the Board. Exchange Participants are advised to consult their legal representatives on all aspects of liabilities under the Laws of Hong Kong, such as the Protection of Investors Ordinance, when publishing, circulating or distributing any invitation or advertisement.

REQUIREMENTS

An Exchange Participant or Dealing Partnership shall comply with the following requirements in publishing, circulating or distributing any invitation or advertisement:-

- (1) The invitation or advertisement shall not contain information considered by the Board to be false, biased, misleading or deceptive.*
- (2) The invitation or advertisement shall not contain any word or phrase that may reasonably give investors the impression that can make profit or that profits are guaranteed.*
- (3) The invitation or advertisement shall not seek to denigrate the reputation of any other Exchange Participants.*
- (4) The invitation or advertisement shall not have any language or artwork which in the opinion of the Board is in bad taste.*
- (5) The invitation or advertisement shall not disclose the position ranking in terms of trading turnover of the Exchange Participant.*
- (6) The invitation or advertisement shall not disclose which constituency the Exchange Participant is in.*
- (7) The invitation or advertisement shall contain a risk disclose statement that the price of shares may fluctuate.*
- (8) The publication, circulation and distribution of any invitation or advertisement shall cease immediately and be retrieved if, in the opinion of the Board, that invitation or advertisement is in contravention of these Regulations.”*

It is therefore recommended that, in order to level the playing field, exempt dealers are required to acquire Exchange Trading Rights to perform regulated activity so that they will be equally regulated by the relevant rules and regulations of the Exchanges.

Yours faithfully,
For and on behalf of
Wocom Holdings Limited

Marcus Hung
Executive Director